

**Internal Revenue Service**

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Person To Contact:

Telephone Number:

Refer Reply To:  
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Legend

X =

A =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7

Dear

This responds to a letter dated November 28, 2007, and prior correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on D1. X elected to be treated as an S corporation effective D2. Trust 1, a trust that was treated (under subpart E of part I of subchapter J of chapter 1) as owned by A, was a shareholder of X. On D3, A died. Trust 1 continued to qualify as a permissible S corporation shareholder under § 1361(c)(2)(A)(ii) for the two-year period beginning on the day of A's death and ending on D4.

On D5, Trust 1 became an ineligible shareholder of X. As a result, X's election to be an S corporation terminated on D5. Trust 1 was intended to have been an electing small business trust (ESBT) under § 1361(e) effective D5, but no ESBT election was properly filed by the trustee of Trust 1. On D6, Trust 1's stock in X was transferred to Trust 2, Trust 3 and Trust 4 (collectively "Trusts"). Trusts were intended to have been ESBTs under § 1361(e) effective D6, but no ESBT election was properly filed by the respective trustees of Trusts.

X represents that the failure to timely transfer Trust 1's shares of stock in X to an eligible shareholder and the failure to file the ESBT election for Trust 1 and Trusts was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an

individual who is a citizen or resident of the United States may be a shareholder. Section 1361(c)(2)(A)(v) provides that an ESBT may be a shareholder.

Section 1362(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death may be a shareholder.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(2)(B), an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a PCB, (ii) no interest in such trust was acquired by purchase, and (iii) no election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee of the ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-(m)(2)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based on the information submitted and the representations made, we conclude that X's S election terminated on D5 when Trust 1 became an ineligible S corporation shareholder and that the termination was inadvertent within the meaning of § 1362(f).

We hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D7 and thereafter, provided that X's S corporation election was otherwise valid and was not otherwise terminated under § 1362(d). Trust 1 will be treated as an ESBT from D7 until D6. Trust 2, Trust 3 and Trust 4 will be treated as an

ESBT from D6 and thereafter. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

This ruling is contingent upon (1) the trustee of Trust 1 filing an ESBT election effective D7 with the appropriate service center, (2) each of Trust 2, Trust 3 and Trust 4 filing an ESBT election effective D6 with the appropriate service center, (3) Trust 1 filing amended returns for taxable years beginning D7 and thereafter consistent with the treatment of Trust 1 as an ESBT, and (4) Trust 2, Trust 3, and Trust 4 filing amended returns for taxable years beginning D6 and thereafter consistent with the treatment of Trust 2, Trust 3 and Trust 4 as an ESBT. The ESBT election and the amended returns must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether X is otherwise eligible to be treated as an S corporation or whether Trusts are eligible to be ESBTs.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

Melissa C. Liquerman  
Senior Technician Reviewer, Branch 2  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for section 6110 purposes